PIERCING THE VEIL OF CORPORATE ENTITY.

Perhaps no two authorities on the law of corporations are in complete accord as to the exact nature of the juristic concepts of corporate entity and corporate personality. Corporations have been regarded as "but associations of individuals,"[1] as artificial personalities,[2] as merely "the sum of legal relations" subsisting in respect to the corporate enterprise.[3] They have even been regarded as actual persons and dealt with in a quite anthropomorphic manner.[4] A brilliant writer has recently suggested that corporate entity is not imaginary or fictitious but quite real, whereas corporate personality is a fiction whose origin is to be found in the psychological tendency towards personification.[5] It is not the present purpose of the writer to discuss these divers theories or to indulge in the tempting but profitless discussion—more metaphysical than legal—as to the true anatomy of the corporate concept. The difficult problem for the corporation lawyer of today is to learn how to employ the concept, to know when to apply fearlessly the theory of the existence of a corporation as an entity distinct and separate from its shareholders and when, on the other hand, just as fearlessly to disregard it. And the voices of the Sirens are at hand to decoy all but the most wary.

All writers on corporation law agree that in certain cases and at certain times a corporation is to be regarded as an entity quite separate and apart from the individual shareholders. Practically all writers agree, also, that in some cases this entity theory must be disregarded. Sometimes we look upon the corporation as a unit, at other times we look upon it as a collection of persons. When should the concept of corporate entity be adhered to, when should it be disregarded?

The concept is not an "open sesame," which will open all gates. When to use it, when to ignore it, is the present day dilemma. The scope and purpose of this article is to seek to supply an answer and to indicate in what classes of cases the

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[1]Lumpkin, J., in Hightower *v.* Thornton (1850) 8 Ga. 486, 492; *cf.* Morawetz, Private Corporations, (2nd ed.) Preface.

[2]Marshall, C. J., in Dartmouth College *v.* Woodward (U. S. 1819) 4 Wheat. 518, 636; *cf.* 1 Bl. Comm., 467-8.

[3]Taylor, Private Corporations, (2nd ed.) §§ 36, 51.

[4]Holzendorff's Rechtslexikon, art. Juristische Person: Prof. Gierke.

[5]Arthur W. Machen Jr., 24 Harv. L. Rev. 253, 347.

"entity concept" should be ignored; incidentally, to demonstrate how the courts, again and again, have frustrated each and every attempt to commit iniquity, to perpetrate fraud, to achieve monopoly, or to accomplish wrongs, under the guise, and hiding behind the veil, of corporate existence. The refusal of the courts to allow quiddits and quillets to stand in the way of justice is nowhere better exemplified.

It has been oftentimes stated that courts of law invariably adhere to the entity theory even though gross miscarriages of justice result. It is quite true that equity, less abashed by forms or fictions than a court of law, is more willing to draw aside the veil and look at the real parties in interest. However, courts of law have, again and again, refused to be trammeled by scholastic logic and mediæval corporate ideas, which frequently serve only to distort or hide the truth. This word of warning, therefore, at the outset: while equity more willingly and more frequently regards the corporation as a collection of persons than does a court of law, yet as will be seen, the rule in courts of law is not unbending.

As early as 1809, it was perceived that in many cases the literal application of the notion that a corporation is only a legal entity, and nothing more, would work injustice. The Supreme Court of the United States, from its genesis, had taken over the language of the year books, and proclaiming its allegiance, had agreed with Coke that "a corporation aggregate of many is invisible, immortal, and rests only in intendment and consideration of the law."[6] Now, if a corporation is merely a legal entity, if it is clothed only with invisibility and intangibility, it could not, of course, be a citizen of a state. The federal constitution, however, in article three, section two, limits, *inter alia,* the jurisdiction of the federal courts "to controversies between *citizens* of different states." In 1809,[7] Chief Justice Marshall, therefore, in order to preserve the jurisdiction of the federal courts over corporations was compelled to look beyond the entity "to the character of the individuals who compose the corporation." The court proclaimed that "substantially and essentially" the parties to the suit are the stockholders, and that of their several citizenships, cognizance would be taken. It is not within the scope of this article to discuss the development and history of this now repudiated ruling.

[6] 10 Co. Rep. 32 b; and see Co. Litt. 250 a.

[7] Bank of United States *v.* Deveaux (U. S. 1809) 5 Cranch 61.

One theory of federal jurisdiction today is that a corporation is an association of persons, citizens,—fortified and buttressed by an arbitrary legal fiction that these persons are citizens of the state fathering the entity.[8] The other theory regards a corporation "to all intents and purposes as a person, although an artificial person, * * * capable of being treated as a citizen of that state, as much as a natural person."[9]

It is simply necessary for present purposes to note that as early as 1809, the United States Supreme Court did not regard it as reasonable that the operation of the concept should be permitted to oust the federal courts of their important and far-reaching jurisdiction over corporations, a result which any overzealous adherence to the theory of corporate entity would inevitably entail. Already at that day, "courts have drawn aside the veil and looked at the character of the individual corporators."[10]

The breach in the rampart had been made. The mediæval bulwark had been stormed. Marshall's decision, though later disregarded and overruled—in fact, he himself is said to have indicated his impatience with it[11]—had served to indicate that a clearer perspective often followed where the web (or as Mr. Taylor would probably say, the cob-web) of corporate entity was fearlessly brushed aside.

An important and most illuminating line of cases where courts refuse to be tied down by the entity theory is seen in the numerous instances of judicial impatience with all attempts to hamper, delay or defraud creditors by means of "dummy" incorporations. In all such instances courts, whether of law, of equity or of bankruptcy, do not hesitate to penetrate the veil and to look beyond the juristic entity at the actual and substantial beneficiaries. The decision of the New York Court of Appeals in *Booth* v. *Bunce*[12] is one of the earliest in point. In that case the members of a financially embarrassed partnership united in forming a manufacturing corpora-

[8]Grier, J., in Marshall *v.* Baltimore & Ohio R. R. Co. (U. S. 1853) 16 How. 314, 328-329; Shiras, J., in St. L. & San F. R. R. Co. *v.* James (1896) 161 U. S. 545, 562.

[9]Wayne, J., in Louisville, Cincinnati & Charleston R. R. Co. *v.* Letson (U. S. 1844) 2 How. 497, 558.

[10]Williams, C. J., in Fairfield County Turnpike Co. *v.* Thorp (1839) 13 Conn. 173, 179, commenting on the decision in Bank of U. S. *v.* Deveaux *supra.*

[11]Remarks of Wayne, J., in Louisville, etc., R. R. Co. *v.* Letson *supra* 555.

[12](1865) 33 N. Y. 139.

tion, under the general incorporation laws. They then transferred to it the property of the partnership. X was a *bona fide* creditor of the partnership; Y, of the corporation. The issue was, in substance, a contest between them to secure their respective claims out of certain personal property transferred by the partnership to the corporation. The court held that the property transferred might be taken on execution by X, since it appeared that the corporation was formed in bad faith and with the intent to defraud creditors.

The trial court charged the jury:

"they had to determine but one question, and that was, that if this corporation was fairly organized, and the sale of the property to it by Montgomery and Lund (the partners) was also fair and done without fraudulent intent, the defendants (Y) were entitled to recover; if, on the contrary, the company was organized to defraud the creditors of Montgomery and Lund, and the property was transferred to them by Montgomery and Lund in furtherance of that fraudulent purpose, the plaintiff (X) was entitled to recover. * * *"[13]

This charge, on appeal, was upheld. The defendants, of course, invoked the sacred doctrine of corporate entity. They insisted that the court had no right to ignore that holy concept. The learned court, however, recognized that there was no magic in incorporation and declaring that the vice of fraud contaminated anything,—even the device of incorporation,—held the entity for all practical purposes a nullity. The scheme was clever, but it did not meet with success. The court, to its credit, was not afraid to lift the veil.

Be it noted that this case was in a court of *law*. The suit was in tort for conversion. Yet it was said:

"* * * Deeds, obligations, contracts, judgments, and *even corporate bodies* may be the instruments through which parties may obtain the most unrighteous advantages. All such devices and instruments have been resorted to, to cover up fraud, but whenever the *law* is invoked all such instruments are declared nullities; they are a perfect dead letter; the law looks upon them, as if they had never been executed. * * *"[14]

In other words, courts of law do not tolerate any attempt to hinder, delay, or defraud creditors by means of a resort to "the veil of corporate entity." The ingenuity of the rogue, with his arsenal of scholastic sophistry, was met and overwhelmed by the sane and stern refusal to be bound by the entity theory.

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[13] *Ibid.* 156.

[14] *Ibid.* 157.

In a recent bankruptcy case,[15] the receiver applied to extend his receivership to the property of a corporation which he alleged to be a mere *alter ego* of a bankrupt partnership. The members of the partnership firm owned 485 shares of the outstanding stock; the other five shares outstanding were owned by a close relative of one of the partners. Business between the corporation and partnership was conducted in such manner that the state of accounts between them was impossible of ascertainment. The argument, of course, was made in behalf of the bankrupts and the corporation that the corporation "existed as a separate and distinct entity." The court brushed aside this contention and declared that the doctrine of corporate entity is "not so sacred" that courts, looking through shams and forms to the actual substance of things, may not ignore the concept in order to preserve the rights of innocent parties or to circumvent fraud. The corporation, it was pointed out, was organized merely to give these disingenuous individuals a double line of credit and to hinder and delay their creditors in the event of insolvency. There was no hesitation. There were no qualms. The court, penetrating the subterfuge, subjected the entire property, both that of the corporation and of the partnership, to the claims of creditors. Hands may be held up in horror at the circumstance that five shares of the corporate stock were not owned by members of the partnership. The court held, and quite correctly, that this was quite immaterial under the glaring circumstances of the case. The decision is submitted to be sound. The corporate organization was but an *alter ego* of the partnership. It was the same pack of thievish wolves, whether in the "entity" garments of little Red Riding Hood's grandmother or in their own furry coats. One was subsidiary and auxiliary to the other. To allow the doctrine of corporate entity to intervene would be to convert a court of justice into a public laughing stock.

Another illustrative decision is *Hibernia Insurance Company* v. *St. Louis & New Orleans Trans. Co.*[16] That case arose in *equity* and it was held that chancery would not permit the stockholders in one corporation to organize another and transfer all the corporate property of the former to the latter, without paying all the corporate debts. It was further held that where such a transfer is made, the obligations of the old corporation may be enforced against the new corporation to the full extent of the assets

[15] In re Rieger, Kapner & Altmark (1907) 157 Fed. 609.

[16] (1882) 13 Fed. 516.

received. Again, we see the concept of corporate entity ignored. Is not the decision reasonable? After all, looking at the real and substantial parties in interest—the bone and muscle men and women shareholders,—is it not clear that all they did was to change their habiliments? Is it not reasonable to hold, as the court did, that they could not by the device of incorporation shield their property from the payment of their just debts? Would a contrary decision not amount to judicial exaltation of a stumbling block? Would it not be a mockery to hold otherwise? Is not the court justified in shaking aside form and phantom in order to get at the substance?

In *Montgomery Web Company* v. *Dienelt*,[17] the situation was quite similar to that in the preceding case. The suit was by a creditor of one company to set aside a conveyance by it to another, as in fraud of his rights. It appeared that the latter company was formed substantially by the shareholders of the former, who gave up their stock in it for stock in the latter, this being substantially all the consideration given. This was unanimously held to be a fraud upon the creditors of the former company. The court said:

"* * * The only real difficulty in the present case is whether the stockholders are so completely severed, in the view of the law, from the corporation behind which they hide, as to prevent a creditor from asserting their identity in fact, for the purpose of securing payment out of property which was theirs under one name, and is still theirs under another. Is the Montgomery Company so completely a new and different person from the Aronia company that the law must close its eyes to the fact that the difference is a mere juggle of names? *We do not think there is any compulsion to such legal blindness.* * * *"[18]

One other case will serve to make it clear that the courts ignore the concept of legal corporate entity when used as a shield for fraudulent attempts to swindle creditors. In *First National Bank of Chicago* v. *Trebein Company*,[19] an insolvent individual, one F. C. Trebein, together with his wife, his daughter, his son-in-law, and his brother-in-law, formed a corporation and then conveyed to it every vestige of tangible property which he owned. His creditors insisted and proved that the purpose in creating the corporation was to hinder and defraud them. The court held

[17](1890) 133 Pa. St. 585.

[18]*Ibid.* 595.

[19](1898) 59 Oh. St. 316.

that "the corporation was in substance another F. C. Trebein," and that "his identity as owner of the property was no more changed by his conveyance to the company than it would have been by taking off one coat and putting on another." It was held to be immaterial that four out of five hundred shares of stock were held not by Trebein himself but by his relatives; that circumstance quite properly did not deter the Supreme Court of Ohio from deciding that the corporation was "in substance another F. C. Trebein."

Even the over-fervent adherent of the orthodox entity theory must concede that these decisions ignore the concept, and very justly. To give further instances would be to reiterate without need.[20]

Closely related to the preceding group of cases are the already numerous and constantly increasing number of decisions which hold that where a corporation is so organized and controlled and its affairs are so conducted as to make it a mere instrumentality or agent or adjunct of another corporation, its separate existence as a distinct corporate entity will be ignored, and the two corporations will be regarded in legal contemplation as one unit. A striking illustration—perhaps the most notable—is the recent decision, *In Re Muncie Pulp Company*.[21] In that case, the Pulp Company caused the incorporation and organization of the Great Western Natural Gas Company, and the transfer to it of its gas and oil wells and lands. The president and treasurer of the pulp company owned every share of stock of the Great Western Company, save one share which was held by a third person in order to have a resident director in Indiana, the state of incorporation. The Great Western Company kept no separate books, its affairs were managed by the Pulp Company, and it was treated as an agent of the Pulp Company for all purposes. Subsequently the Pulp Company went into bankruptcy. The receiver demanded the delivery to him of the property of the Great Western Company as a part of the assets of the Pulp Company and was refused. The court sustained the receiver, and held that the Great Western Company was merely the dummy of the bankrupt Pulp Corpora-

[20]See also: Donovan *v.* Purtell (1905) 216 Ill. 629; Kellogg *v.* Douglas County Bank (1897) 58 Kan. 43; Bremen Saving Bank *v.* Branch etc. Co. (1891) 104 Mo. 425; Lusk *v.* Riggs (1902) 65 Neb. 258, 262; Terhune *v.* Hackensack Savings Bank (1889) 45 N. J. Eq. 344; Andres *v.* Morgan (1900) 62 Oh. St. 236; Bennett *v.* Minott (1896) 28 Ore. 339; Vance *v.* McNabb Coal etc. Co. (1892) 92 Tenn. 47; Accord.

[21](1905) 139 Fed. 546; 71 C. C. A. 530.

tion, and that its property belonged in law to the bankrupt. In his opinion, Coxe, Circuit Judge, said:

"The Great Western Company was undoubtedly a mere creature of the pulp company, having no independent business existence, and organized solely for the purpose of facilitating the business of the latter. The Great Western Company has no shadow of claim to the property in controversy, and to permit it, or its president, or shareholders, to dispose of such property, is to sanction a fraud upon the creditors of the pulp company. * * *"[22]

It is not enough, however, that shareholders in two corporations are identical. It is not enough that one owns shares in the other. It is not enough that they have mutual interrelated dealings. In order to disregard the entity it must clearly appear that one corporation is but the "business conduit" of the other.

Perhaps in no manner can these propositions involved be more clearly illustrated than by contrasting the actual decisions. To illustrate: In *Interstate Telegraph Company* v. *Baltimore and Ohio Telegraph Company*,[23] it appeared that a railroad corporation caused a telegraph company to be incorporated, became the sole owner of its stock, elected its own officers and employees as officers thereof, and held out such company as authorized to contract for its whole railway telegraph system. It was held that the railway company was, in truth, the owner of the telegraph company, and that the latter company was a mere department, or bureau, of the railroad company, only created and maintained for the railway company's benefit as an agent to make contracts. The inevitable corollary follows that, had the railroad corporation become insolvent during the existence of the telegraph company, the court would have treated the telegraph company's property as the property of the railroad company,—notwithstanding the agonizing pleas for separate corporate entity which undoubtedly would have been raised by astute counsel.

On the other hand, the recent case of *In re Watertown Paper Company*[24] demonstrates how hazy is the border-line and how supremely difficult it is to determine when to tear aside the barrier of distinct corporate existence and when to leave it undisturbed. In that case, after the organization of a paper company, its stockholders caused the organization of a pulp company, with funds advanced by the paper company, but for the account of its stock-

[22] *Ibid.* 548.

[23] (1892) 51 Fed. 49, aff'd. (1893) 54 Fed. 50.

[24] (1909) 169 Fed. 252.

holders to whom the advancements were charged. The paper company itself owned no stock of the pulp company. While the two corporations mingled their affairs, *e. g.*, the paper company purchasing its pulp, supplies, etc., from the pulp company, and the stockholders in control apparently regarded the two corporations merely as different departments of one general business, yet separate corporate organizations were kept up, distinct sets of corporate books were maintained, and each conducted its own business in its own name. The court held that the affairs of the two corporations were not so conducted as to make one company a mere dummy or instrumentality of the other and that the pulp company could enforce its claim against the bankrupt estate of the paper company. Noyes, Circuit Judge, recognized the rule laid down in the preceding cases but distinguished the case before him on the grounds, 1, that separate corporate organizations were kept up; 2, that each corporation had its own creditors, its own assets, and conducted business in its own name; 3, that separate books of account were kept. He seemingly regarded it as immaterial that, at times, the two corporations mingled their affairs and that lax business methods between them were plainly shown. The decision is marked by a tendency to stick somewhat overclosely to the entity theory. The learned judge conceded that it might be disregarded in order to circumvent fraud, or where one corporation, as in the *Muncie Case supra,* was but a separate name for the other. The *Watertown Case,* however, he did not deem as coming within the exceptions but rather within the rule that the distinct corporate existence of two separate, although associated, corporations will be upheld by the courts.

It cannot be too strongly emphasized that mere identity of stockholders *per se* does not operate to destroy the distinct corporate existence, of two corporations. So much is clear.[25] It must further appear by clear and convincing evidence that the corporation created is only an adjunct of the business of its creator,—a mere agency, or instrumentality, through which it acts,—a mere business department, or bureau, so to speak. Once, however, these facts appear, a court, whether of law or equity or bankruptcy, should look through the thin guise of corporate entity to

[25]Richmond & I. Construction Co. *v.* Richmond R. R. Co. (1895) 68 Fed. 105, 108, 15 C. C. A. 289; Lange *v.* Burke (1901) 69 Ark. 85, 88; Waycross Airline R. R. Co. *v.* Offerman & W. R. R. Co. (1900) 109 Ga. 827; N. Y. Airbrake Co. *v.* International Steam Pump Co. (N. Y. 1909) 64 Misc. 347, 120 N. Y. Supp. 683, per Greenbaum, J.

the actual substance of things and should not hesitate to cast aside the entity concept in order to achieve justice.

Where a corporation is organized as a mere sham or device in order to evade an existing legal obligation, recent decisions establish that the courts, even without regard to actual fraud, are wont to disregard the entity theory. There is perhaps no better illustration of this rule than the recent decision of the supreme court of California in *Higgins* v. *Cal. Petroleum & Asphalt Company, et al.*[26] A lessee corporation in that case, with intent to evade the payment of royalties under a lease, conveyed title to a second corporation. The main, apparently the sole, purpose of this organization was to evade the obligations of the lease. Thereafter, the second corporation conveyed to a third, seemingly with the same end still in view. It appeared that each of the three corporations had substantial identity. Each had been formed by the same persons. They "'had their offices together in the same room, had practically the same officers and were organized by the same persons and for substantially the same purposes.'" The court did not find that there was any actual fraud in the transaction. Without regard to actual fraud, however, in the formation of each of the succeeding corporations, and the transfer of title thereto, such transfer as against the lessor holding an existing obligation against the original lessee corporation was held, nevertheless, "constructively fraudulent as a matter of law." The court decreed that all of the corporations were jointly liable for the royalties to the lessor, saying that "the three corporations defendant are really the same."[27] This decision—all the stronger because at law and not in equity—and those in harmony with it, are sound law. To allow the concept of legal entity, attributed to a duly formed incorporated company, to stand as a stumbling block in the path leading to justice would be tantamount to allowing the greatest iniquity to be perpetrated under the concept as a shield. It would be contrary to the very genius of the concept itself to allow it to be used for ends and for purposes subversive of its reason.

Similarly in *Brundred* v. *Rice*,[28] the promoters of a corporation organized a separate entity for the purpose of consummating an illegal railway rebate agreement, thinking no doubt to shield

[26](1905) 147 Cal. 363.

[27]*Ibid.* 368.

[28](1892) 49 Oh. St. 640.

themselves from consequences in that manner. They had the effrontery, *mirabile dictu,* even when all the facts were laid bare in open court, to claim that the interposition of a "legal entity" precluded their being held personally liable. It was held that "the act of incorporating can be of no avail to them as a defense." The court, penetrating the sham, rightly declared that there was nothing "sacred in a certificate of incorporation," and that their ingenious, tricky device was of no avail. Again in this case, the proceedings were in a court of law, and not in equity. There was, however, not the slightest hesitation manifested in penetrating to the essential root and gist of things.

One further illustration will suffice. In *Donovan* v. *Purtell,*[29] a clever and unscrupulous real estate operator organized a number of different realty companies, all of which were so much "straw." They all had their offices in the same room, they all had substantially the same officers, and the main purpose of the organization of each was to keep the various properties owned by the operator out of judgment. As testified to by one witness,

"'* * * there were judgments against these different companies, and he (Donovan, the operator) would get up another company and put the property in the name of the new company, in order that it could be transferred, so that there would be no judgment against it.' That he used the property of the companies indiscriminately."[30]

The sum and substance of the whole matter was that the corporations, in point of fact, were really the real estate operator under different cloaks. It was held that an individual who had dealt with one of these corporations, as such, could hold the operator personally liable. As said by Mr. Justice Magruder, speaking for the Supreme Court of Illinois,

"* * * When appellant received appellee's money, he was not conducting business under a *bona fide* corporate organization, but was using a corporate entity for the transaction of his private business * * *."[31]

The court indicated its refusal to be trammelled by the theory of corporate entity and impatiently ignored the usual defense,—the "corporate concept"!

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[29](1905) 216 Ill. 629.

[30]*Ibid.* 634.

[31]*Ibid.* 641.

Oftentimes the corporate form of organization is adopted in an endeavor to evade a statute or to modify its intent. A forceful example is to be found in the recent decision of the United States Supreme Court disregarding the theory of corporate entity in enforcing the "commodities clause" of the Hepburn Act.[32] The commodities clause provides that

"It shall be unlawful for any railroad company to transport from any State * * * to any other State * * * any article * * * manufactured, mined or produced by it, or under its authority, or which it may own in whole or in part, or in which it may have any interest direct or indirect * * *."

The government, in the first suit, alleged that the Lehigh Valley Railroad Company owned stock in a coal company whose goods it was carrying. On demurrer, it was held that no violation of the statute was thereby shown; the court interpreted "interest direct or indirect" as meaning only a legal or equitable interest in the transported articles.[33] The government, after this first and much-to-be questioned blow, presented an amended complaint in which it was set forth, in addition to the allegations of the prior complaint, that the railroad company was using the coal company merely as a sham, a device and a dummy, in order to evade the provisions of the act. The court held that no such evasion could succeed, and disregarding the corporate concept and looking at the substance and reality of things, decided that it was within its jurisdiction to issue an injunction.[34] It is submitted that every dictate of sound reason warranted the court in holding as it did.

The late Justice Brewer in his notable concurring opinion in *Northern Securities Company* v. *United States*,[35] pointed out that where a corporation was organized merely as a convenient means of combining separate railroad properties under one control, the court could shake aside the veil of entity and regard the combination as just "as direct a restraint of trade by destroying competition as the appointment of a committee to regulate rates." In other words, the plain intent and purport of the Sherman Anti-Trust Act cannot be defeated by a resort to the sham and subterfuge of incorporation.

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[32]U. S. *v.* Lehigh Valley R. R. Co. (1911) 220 U. S. 257, 31 Sup. Ct. Rep. 387, (per White, C. J.)

[33]U. S. *v.* Delaware & Hudson Co. (1909) 213 U. S. 366, esp. 413.

[34](1911) 220 U. S. 257 *et seq.*

[35](1903) 193 U. S. 197, 360-4.

In *United States* v. *Milwaukee Refrigerator Transit Company*,[36] a dummy corporation was formed in order to evade the provisions of the Interstate Commerce Act, and of the Elkins Act of 1903. The Pabst Brewing Company, which had organized the Transit Company in order thus indirectly to obtain illegal rebates raised the usual stereotyped hue and cry of distinct corporate entity. Although the evidence showed that the Transit Company was merely the *alter ego* of the Brewing Corporation, that they were substantially identical in interest and control, that the dummy Transit Corporation could have been organized only with intent to evade the law, although the Brewing Company was the ultimate beneficiary, yet it was strenuously, nay vehemently, insisted "that a corporation is a legal entity" and that the government was remediless. The court exploded the theory of the defense, hoisted the distinguished counsel on their own petard,—and indicating that the Transit Company was a mere separate name for the Brewing Company, being in fact the same collection of persons and interests,—stamped the device adopted as "neither new, nor deserving of any success." In other words, people cannot obtain legal immunity for deliberate wrongdoing by a resort to the "entity bath." Or, otherwise expressed, statutes cannot be violated by a resort to the corporate subterfuge. Courts will break away from the notion that a corporation is only a legal entity whenever its literal application would operate abortively.

The burning words of a late Chancellor of New Jersey should be borne in mind by every corporation lawyer who seeks to use the concept of corporate entity to defeat the end for which it was invented:[37]

"'* * * A more flimsy device, when the particulars are once known, it is impossible to imagine. It may succeed for a time in baffling persons. * * *'

"It must not be thought that courts are powerless to strip off disguises that are designed to thwart the purposes of the law. The mere suggestion of such a condition is an insult to the intelligence of the judiciary. Whenever such disguises are made apparent they can readily be disrobed. The difficulty is in showing the disguises, not in penetrating them when they appear."

A recent decision, following numerous others, by the United States Supreme Court, speaking through the late Justice Harlan, emphasizes another phase of the disregard of corporate entity where

[36](1905) 142 Fed. 247, (per Sanborn, J.)

[37]Stockton *v.* Central R. R. Co. (1892) 50 N. J. Eq. 52, 75-6, citing abundant authority.

the corporation is a mere shift to evade the law. In that case, a corporation was formed for the sole purpose of attempting to get a certain litigation into the federal courts, and thus of invoking federal rather than state jurisdiction. The entity was impatiently, almost contemptuously, disregarded.[38]

Further illustrations *ad infinitum* might be given; they would serve not so much further to fortify this principle as to introduce needless repetition.

In cases involving an attempt to monopolize, it has of late become most necessary, both from a just and a practical standpoint to look behind the corporate body and recognize the individual members. The leading case, and one of the most famous of these holdings, is *People* v. *North River Sugar Refining Company*.[39] Proceedings in *quo warranto* were brought against the company by the state of New York to deprive it of its corporate franchise for the reason that it had abused its rights and obligations by becoming a party to a forbidden and wholly illegal trust agreement. The corporation insisted that it had never entered into the contract, but it appeared that the contract was signed by each and every shareholder. It was strenuously argued by as able counsel as were then at the New York bar, Messrs. James C. Carter and John E. Parsons, that the agreements were those only of the individual shareholders in their private capacities and with regard to their private property, and hence not corporate action or misconduct. It was contended that the absence of any formal action by the directors of the corporation proved that it, the entity, was free from guilt. It was urged that the illegal combination was the result merely of dealings and acts of the stockholders and not of any corporate action and that, therefore, the entity was not chargeable with any wrongdoing or misbehavior. The Court of Appeals affirmed the judgment of dissolution rendered in the court below and charged the entity with the acts of the stockholders and officers, deciding that under the circumstances of the case, their acts were the acts of the corporation itself.

The court pointed out the utter ridiculousness of the appellant's argument that "while all that was human and could act had sinned, yet the impalpable entity had not acted at all and must go free."[40]

[38]Miller and Lux *v.* East Side Canal etc. Company (1908) 211 U. S. 293 and cases cited.

[39](1890) 121 N. Y. 582.

[40]*Ibid.* 619.

The stockholders, the acting and living men and women. had been guilty of misconduct. It would be nothing short of absurd to say that although they were guilty, the corporate robe that enveloped them was spotless and they must, *a fortiori,* be left to wear it free and undisturbed. The scope of this article does not warrant a consideration of the monopolistic aspect of the decision. For present purposes, it is sufficient to note that the court ignored the corporate concept, brushed aside the entity and did not hestitate to "look beneath it at the actions of the individuals upon whom the franchise was conferred." As said by Judge Finch in his learned opinion:

"* * * The State gave the franchise, the charter, not to the impalpable, intangible and almost nebulous fiction of our thought, but to the corporators, the individuals, the acting and living men, to be used by them, to redound to their benefit, to strengthen their hand, and add energy to their capital. * * * The benefit is theirs, the punishment is theirs, and both must attend and depend upon their conduct; and when they all act, collectively, as an aggregate body, without the least exception, and so acting, reach results and accomplish purposes clearly corporate in their character, and affecting the vitality, the independence, the utility, of the corporation itself, we cannot hestitate to conclude that there has been corporate conduct which the state may review, and not be defeated by the assumed innocence of a convenient fiction. * * *"[41]

The justice of this decision is clear. To hold otherwise would be to ignore the real and substantial parties in interest, blinding the eyes not only to the facts but to the justice of the situation, and, admitting the sins of the body, to insist that the sinner remains pure.

Two years after the decision of the New York court, a similar decision was rendered by the Supreme Court of Ohio in the now famous case of *State* v. *Standard Oil Company.*[42] In that case all, or at least a great majority, of the stockholders comprising a corporation entered into an illegal trust agreement in their individual capacities for the purpose of concealing the real nature and object of their actions. The property and business of the company were affected in the same manner and to the same extent as if there had been a formal resolution of the Board of Directors. To prevent the abuse of corporate power, the State of Ohio challenged the proceedings by an action of *quo warranto.* The able attorneys

[41] *Ibid.* 622.

[42] (1892) 49 Ohio St. 137.

for the Standard Oil Company, Joseph H. Choate and S. C. T. Dodd among them, again raised the plea of corporate entity. They urged in the first point of their brief that:

"It is a modern heresy, largely invented during the late crusade against the principle of association in business, that a corporation is not a 'legal entity,' but simply an association of stockholders with certain legal faculties. * * *"[43]

They claimed that the legal entity could not be effected by any acts or agreements except such as were executed in formal manner on its behalf by its corporate agencies. The Supreme Court of Ohio reached the same result as the New York Court of Appeals, strangely enough not citing or quoting from the *North River Sugar Refining Co. Decision.* The Attorney General, however, had called the court's attention to that case.[44]

An extract from the learned opinion of Minshall, *J.*, indicates the court's attitude:

"* * * Disregarding the mere fiction of a separate legal entity, since to regard it in an inquiry like the one before us would be subversive of the purpose for which it was invented, is there, upon an analysis of the agreement, room for doubt, that the act of all the stockholders, officers and directors of the company in signing it, should be imputed to them as an act done in their capacity as a corporation? We think not, since thereby all the property and business of the company is, and was intended to be, virtually transferred to the Standard Oil Trust, and is controlled, through its trustees, as effectually as if a formal transfer had been made by the directors of the company. * * *"[45]

The decision is notable as marking again the intention of a court of last resort to ignore the concept of corporate entity whenever and wherever extended to an intent and purpose unreasonably and illegally to restrain trade, or to monopolize or to seek to monopolize, and, therefore, not within the reason or policy of the concept. To permit the notion of legal entity to stand in the way of a decision which justice and public policy requires, to allow a metaphysical sophism and concept to interfere with state control of corporations, to permit restraint of trade and monopoly itself to be achieved under the guise of refined and abstruse philosophical reasoning, or lack of reasoning,—is abhorrent to the genius and

[43] *Ibid.* 167.

[44] *Ibid.* 163.

[45] *Ibid.* 184.

spirit of both the common law and chancery. To the credit of our courts, it must be conceded that when tried in the balance they have not been found wanting,—in this important regard.

Still one other line of decisions admirably illustrates the refusal to permit monopoly to be attained under the cover of corporate entity. As good examples as any of this second phase are the decisions of the Supreme Court of Illinois in the Milk and Whiskey Trust cases. In the former case,[46] the astute counsel for the monopoly urged, apparently in all seriousness, that the Milk Shippers Association, which had been incorporated, could not be guilty of illegal combination, because the corporation, as an entity, could not enter into a trust or combination with itself. The court's unhesitating answer to this climax of "entity" sophistry was that the actions of the individual shareholders could be regarded, and if they had, together with the entity, combined, they were all alike guilty. In other words, incorporation will not render a combination legal on the ground that the corporation cannot alone enter into a trust, as the *acts of the corporation are those of the associated persons as individuals.* Mr. Justice Phillips, speaking for the court, said:

"* * * There can be no immunity for evasion of the policy of the State by its own creations. The corporation, as an entity, may not be able to create a trust or combination with itself, but its individual shareholders may, in controlling it, together with it, create such trust or combination that will constitute it, with them, alike guilty."[47]

In the same year, the same court decided that the attempt of the whiskey trust[48] to purge itself of illegality by changing its form of organization from an unincorporated association, or "trust," to a corporation was ineffectual. The court drew aside the veil of entity and rightly said that if the trust agreement was repugnant to public policy and illegal, "it is impossible to see why the same is not true of the corporation which succeeds to it and takes its place."

In the light of these decisions, it is clear that there is no magic in incorporation which can purge a monopolizing scheme of its slimy, greedy viciousness. If illegal before incorporation, it is

[46]Ford *v.* Chicago Milk Shippers Association (1895) 155 Ill. 166.

[47]*Ibid.* 180.

[48]Distilling and Cattle Feeding Co. *v.* People (1895) 156 Ill. 448, 490-2.

equally illegal afterwards, and for the same reasons. The legal armor-plate can be torn aside and the acts of the flesh and blood associates, disclosed and scrutinized.[49]

The freely transferable nature of shares of corporate stock oftentimes necessitates a disregard of the entity concept. For example, X has an equitable claim against the Y corporation, because of a corporate fraud upon X in the inducement of a contract. Unquestionably X is entitled to a rescission of the transaction. However, if X delays the assertion of his rights for a long period and meanwhile innocent purchasers have acquired an interest in the corporate property, as shareholders or creditors, a court of chancery would be warranted oftentimes in drawing aside the web of entity and taking cognizance of the human factors.[50]

Again, where the body of stockholders is so circumstanced that no relief should be afforded them, may the corporate entity recover? Will the court adhere to the doctrine at the expense of justice and common sense, or will the stumbling block be pushed aside? The ablest decision in point known to the writer is that of Prof. Roscoe Pound, when a Commissioner of the Supreme Court of Nebraska, the precise situation being presented for his consideration in *Home Fire Insurance Company* v. *Barber*.[51] Declaring that it would be a reproach upon the courts if they could not look behind the corporation to the ultimate beneficiaries, the court denied relief to the corporation. If the stockholders have no standing, and if they are not equitably entitled to the relief sought to be enforced by the corporation in their behalf, the corporation itself will not be permitted to recover. As said by Pound, *C:*

"* * * When the corporation comes into equity and seeks equitable relief, we ought to look at the substance of the proceeding, and if the beneficiaries of the judgment sought have no standing in equity to recover, we ought not to become befogged by the fiction of corporate individuality, and apply the principles of equity to reach an inequitable result."[52]

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[49]See also: Anthony *v.* American Glucose Co. (1895) 146 N. Y. 407; Harding *v.* American Glucose Co. (1899) 182 Ill. 551, 615, *et seq.;* Dunbar *v.* American Telephone & Telegraph Co. (1906) 224 Ill. 9, 25. But see: Edmunds *v.* I. C. R. R. Co. (Ill. 1908) 36 Nat. Corp. Rep. 50, and comment thereon in 8 COLUMBIA LAW REVIEW 320.

[50]*Cf.* U. S. *v.* San Jacinto Tin Co. (1885) 23 Fed. 279; Wetmore *v.* St. Paul. R. R. Co. (1880) 3 Fed. 177; 1 Morawetz, Private Corporations, § 231.

[51](1903) 67 Neb. 644.

[52]*Ibid.* 669.

The case commented upon arose in equity but the rule is by no means peculiar to that jurisdiction. Oftentimes in courts of law, as has already been seen, analogous reasoning has been applied.[53]

Closely allied to the foregoing lines of decisions is the disregard of the entity theory where acts have been undertaken by the entire body of stockholders and attempt then made to escape liability "by conjuring with the corporate name." These cases do not, as in the *Sugar Refining* and *Standard Oil Decisions,* involve any attempt to monopolize, but their reasoning and argumentation are, naturally, quite similar. The courts perforce are obliged to consider that the individual members are, in the last analysis, the true parties in interest.[54]

Few judges have ever been sufficiently foolhardy to seek to sit in cases where a party plaintiff or defendant was a corporation in which the judge held shares of stock. In an early New York case,[55] a judge regarded himself as competent to sit under such circumstances, relying upon the distinction between the corporation and its shareholders. It is true, forsooth, that the shareholders do not appear upon the formal record, yet are they not the parties in substance and the corporation but the party in form? In the next year, Chancellor Sanford had the same question before him. The Washington Insurance Company, in which he was a stockholder, instituted suit in his tribunal. The learned judge immediately directed that all proceedings before him cease and refused to take jurisdiction on the ground that the stockholders were "the real litigants in the suit."[56] The view of Chancellor Sanford is that universally adopted by courts today. In all such cases, so far as the writer knows, the veil of corporate entity is lifted aside.[57]

The entity theory, it stands to reason, must be ignored in stockholders' suits for mismanagement, in determining the rights of the stockholders *inter sese* in equity, in cases of ratification, and in working out problems bearing upon the consolidation and dissolution of corporations. In these cases, however, the disregard

[53]See also: Ark. River, etc. Co. *v.* Farmers Loan & Trust Co. (1889) 13 Colo. 587; Chicago Union Traction Co. *v.* City of Chicago (1902) 199 Ill. 579; Des Moines Gas Co. *v.* West (1878) 50 Iowa 16.

[54]Sheldon Hat Blocking Co. *v.* Eickemeyer Hat Blocking Machine Co. (1882) 90 N. Y. 607, 613; Hotel Co. *v.* Wade (1877) 97 U. S. 13, 23.

[55]Stuart *v.* Mechanics' & Farmers' Bank (N. Y. 1822) 19 Johns. 496, 501.

[56]Washington Ins. Co. *v.* Price (N. Y. 1825) 1 Hopkins Ch. 1.

[57]State *v.* Young (1893) 31 Fla. 594; Inhabitants of Northampton *v.* Smith (Mass. 1846) 11 Metc. 390; Gregory *v.* Cleveland R. R. Co. (1855) 4 Oh. St. 675; Newcome *v.* Light (1882) 58 Tex. 141, (*Semble*).

of the concept of corporate entity is incidental rather than fundamental.

A few courts have argued that a corporation should not be recognized as a separate entity when its stock is owned wholly by one person.[58] It has been insisted, especially in the Supreme Court of Maryland, that when one person owns all the shares of stock of a corporation, he, in virtue of such ownership, becomes the owner of the corporate property, may sell and dispose of it, if he chooses to do so, and, in short, becomes the corporation. This, however, is a minority view and has met with little favor. It is true that courts will be more apt to pierce the veil of corporate entity where one person owns all the corporate stock, but they do this in such cases not because it is a one-man company, not because there is but one shareholder, but because the other circumstances of the case make such action imperative. The writer submits that in practically every case of a one-man corporation where the veil of entity was brushed aside, the same result would have followed had there been a thousand stockholders, or ten thousand. Outside of Maryland, fortunately, there are but few heterodox decisions. One of the most notorious is a comparatively recent holding of the Supreme Court of Alabama. In the *First National Bank of Gadsen* v. *Winchester*,[59] it was held that a mortgage of corporate property by the only two stockholders of the company was valid although no corporate action had been taken. The decision relied upon the reasoning of the Maryland courts.

The cases which hold that the only stockholder in the corporation, or the only two or three stockholders in a corporation, become the corporation itself and can deal with the corporate property *ad libitum* are marked, it is true, by a disregard of the theory of corporate entity, but the disregard is an unsound and erroneous one. It is just in this class of case, standing on such facts *per se*, that the doctrine of corporate entity should be adhered to. The writer does not mean to intimate that if in these cases any of the elements previously mentioned which warrant a disregard of the doctrine of corporate entity are present, that the concept should nevertheless be adhered to. What is meant is this: that simply because a company is reduced in number to one or

[58] Swift *v.* Smith, Dixon & Co. (1886) 65 Md. 428, 434; The Bellona Company's Case (Md. 1831) 3 Bland 442, (*Semble*).

[59] (1898) 119 Ala. 168.

two, or a very few stockholders, does not warrant for a single instant, *per se,* the disregard of the corporate entity. Whether there is one shareholder in a corporation or whether there are ten thousand makes no difference, in other words, unless some of the circumstances aforementioned which warrant a disregard of the theory of corporate entity are present.

A moment's thought and consideration will make clear the reason. Stockholders, as such have no title to corporate property.[60] Stockholders are not tenants in common of the corporate property.[61] In order to keep the title to corporate property free from complication and uncertainty, it has been found absolutely essential for the administration of justice to treat a corporation as a collective entity without regard to its individual shareholders.[62] One illustration will suffice. Suppose X and Y became the sole stockholders in a corporation. If they were permitted to sell, mortgage or otherwise dispose of the corporate property by virtue thereof, titles could not be kept clear and chaos, confusion and hopeless uncertainty would result.[63] The writer, although a firm believer in the necessity for a frequent and liberal disregard of the concept of corporate entity, believes that to ignore it simply because the number of stockholders has become very few, or even one, is to convert an otherwise sane, safe and sensible policy into a *reductio ad absurdum;* and so, to their credit, the majority of American courts have universally held.[64]

The correct doctrine to adopt in these cases, as opposed to that of the wayward Maryland and Alabama courts is well illus-

[60]Pound, C., in Home Fire Insurance Co. *v.* Barber (1903) 67 Neb. 644, 668.

[61]Harton *v.* Johnston (1910) 166 Ala. 317, 322.

[62]Gallagher *v.* Germania Brewing Co. (1893) 53 Minn. 214.

[63]Remarks of Mitchell, J., in Gallagher *v.* Germania Brewing Co. *supra.*

[64]Spencer *v.* Champion (1833) 9 Conn. 536; Exchange Bank *v.* Macon Construction Co. (1895) 97 Ga. 1; Sellers *v.* Greer (1898) 172 Ill. 549; Coal Belt Co. *v.* Peabody Coal Co. (1907) 230 Ill. 164, 168; Hopkins *v.* Roseclaire Lead Co. (1874) 72 Ill. 373, 379; Allemong *v.* Simmons (1890) 124 Ind. 199; George T. Stagg Co. *v.* Taylor (1902) 113 Ky. 709, 718; In Matter of Belton (1895) 47 La. An. 1614; Ulmer *v.* Lime Rock R. R. Co. (1904) 98 Me. 579, 594; Old Dominion Copper Co. *v.* Bigelow (1909) 203 Mass. 159, 192; Rough *v.* Breitung (1898) 117 Mich. 48; Baldwin *v.* Canfield (1879) 26 Minn. 43; Palmer *v.* Ring (N. Y. 1906) 113 App. Div. 643, 99 N. Y. Supp. 290 and cases therein cited; Central Mfg. Co. *v.* Montgomery (1910) 144 Mo. App. 494; Commonwealth *v.* Monongahela Bridge Co. (1906) 216 Pa. St. 108; Rhawn *v.* Edge Hill Furnace Co. (1902) 201 Pa. St. 637; Kendall *v.* Klappherthal Co. (1902) 202 Pa. St. 596; Parker *v.* Bethel Hotel Co. (1896) 96 Tenn. 252; Button *v.* Hoffman (1884) 61 Wis. 20. But see: Buffalo Loan Co. *v.* Medina Gas Co. (1896) 42 N. Y. Supp. 781, 788.

trated in a leading Minnesota decision.[65] In that case, one King, the owner of all the stock in a corporation, executed a deed in his own name, of certain realty owned by it. Subsequently thereto an equitable action was brought by a stockholder to have the deed declared void as a cloud on the title of the corporation. It was unanimously held that the deed was "void upon its face" and therefore not a cloud upon title, "being the deed of a total stranger to the title." A famous Wisconsin decision in which it was held that a sole stockholder could not maintain an action of replevin for corporate property illegally taken by the defendant illustrates, in another manner, the correct holding.[65a]

To reduce this proposition to the form of a rule: corporate entity will not be ignored at law or equity simply because the number of stockholders is few, or even one, unless the circumstances are such as would warrant the same disregard of the entity were there ten thousand shareholders. As a corollary to this, it follows, in the absence of such extraneous circumstances, that where a question of title to corporate property is involved, the concept must faithfully be adhered to, though there be but one stockholder, under the penalty of an otherwise inextricable confusion.

The various classes of cases where the concept of corporate entity should be ignored and the veil drawn aside have now been briefly reviewed. What general rule, if any, can be laid down? The nearest approximation to generalization which the present state of the authorities would warrant is this: When the conception of corporate entity is employed to defraud creditors, to evade an existing obligation, to circumvent a statute, to achieve or perpetuate monopoly, or to protect knavery or crime, the courts will draw aside the web of entity, will regard the corporate company as an association of live, up-and-doing, men and women shareholders, and will do justice between real persons. This is particularly true in courts of equity, but finds many illustrations in courts of law as well, for it must not be thought that "our lady of the Common Law" is not sufficiently powerful to explode sophistry or scholastic theory where used as a cloak for wrongdoing. In neither tribunal is the concept exalted into a fetich to be worshipped "in the sacrifice of those who, in the last analysis, are the real parties in interest."[66]

[65] Baldwin *v.* Canfield *supra.*

[65a] Button *v.* Hoffman *supra.*

[66] Lamar, J., in Oliver *v.* Oliver (1903) 118 Ga. 362; *cf.* Percival *v.* Wright L. R. [1902] 2 Ch. 421.

The successive decisions of the courts indicate a willingness to adjust the entity theory to the evergrowing complexities and constantly increasing problems of the modern private corporation. Again and again, the entity doctrine, and yea, even the precious rule of *stare decisis,* have not been permitted to stand in the way of the achievement of substantial rugged justice. There could be no better refutation of the charge so frequently made *horis novissimis* that courts are inelastic, unyielding and unwilling to respond to social and economic facts than the adjustment—still in process—of corporate concepts to modern business facts. Of course, it stands to reason that the courts lag somewhat behind corporate business; forsooth, cases do not arise until transactions have been engaged in and brought before the courts for a decision. In the main, however, and on the whole, the response has been prompt, certain, and sufficient.

I. MAURICE WORMSER.

UNIVERSITY OF ILLINOIS.